

In Defense of the T&M Subcontract

Daniel A. Chalfant, CPCM

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Introduction

5 War has been declared on the T&M contract!

The Department of Defense (DoD) is restricting the use of the Time and Material (T&M) Contract type¹. In recent years, the DoD has discouraged the use of the T&M contract type, and now requires a Determination and Findings (D&F) that includes an explanation of why another type of contract is not appropriate. This article defends the T&M contract, not for prime recipients, but as a valuable tool for subcontracting.

The Federal Acquisition Regulations (FAR) describe a T&M contract as follows: "provides for acquiring supplies or services on the basis of direct labor hours at specified fixed hourly rates that include wages, overhead, general and administrative expenses, and profit; and actual cost for materials"². In industry, T&M contracts are typically used for repairs or research & development efforts.

15 Although the FAR states that a T&M contract is the least preferred type of contract³, this FAR requirement does not apply to subcontracts issued by prime contractors. Subcontracts are commercial contracts and are only subject to state law and flow down clauses from the prime contract.

DoD Limitations on T&M contracts

25 Some clear indications of these DoD limitations come from the General Accountability Office (GAO) and the DoD Inspector General (IG), where both have issued reports recently criticizing the DoD's use of T&M contracts. The GAO recommended new safeguards and improved controls be applied on T&M contracts⁴. The DoD IG the review, which was in regards to Air Force and Army use of T&M contracts in Southwest Asia (Afghanistan and Iraq), found that T&M contracts were not always properly awarded and administered⁵.

Another example is when the prime contractor is required to obtain consent to subcontract, making it harder to award a T&M subcontract. The requirement for consent can be found at FAR clause 52.244-2 "Subcontracts". It requires the prime contractor to obtain consent to subcontract from the Contracting Officer (CO) in certain situations. Additionally, FAR 44.203 states "the

Contracting officers shall not consent to ...repetitive or unduly protracted use of cost-reimbursement, time-and-materials, or labor-hour subcontracts'."

45 The DoD is also actively limiting the use of T&M Subcontracting in many individual cases. Recently, the US Navy declined to provide consent for a prime contractor to award a T&M Subcontract⁶. And in another case, T&M subcontracts were only approved for small businesses without approved accounting system.⁷

Flaws of T&M subcontract

So, why is the DoD restricting the use of the T&M contract? Some perceived flaws of the T&M contract are:

- 55 1. The profit included in the T&M rate could be considered a 'cost plus percentage of cost' contract. This is prohibited by FAR "No subcontract or modification thereof placed under this contract shall provide for payment on a cost-plus-a-percentage-of-cost basis"⁸.
- 60 2. This profit structure of a T&M contract is an incentive for the contractor to increase labor hours beyond what is considered fair and reasonable.
- 65 3. Uncompensated overtime hours for exempt employees can be invoiced at the full T&M contract rate, despite the fact that these hours may be at no cost to the contractor.
- 70 4. Contractors can substitute low wage employees for high rate labor categories.

Because of these perceptions, the Government typically recommends the use of Cost Plus Fixed Fee (CPFF) contract type in lieu of the T&M type contract.

Industry Preference for T&M subcontracts

75 Prime contractors prefer T&M subcontracts for various reasons. The first applies to ID/IQ Multiple Award Contracts (MAC). An ID/IQ MAC, can require task order proposals due within 5 to 10 days; leaving no time to solicit, analyze, and negotiate subcontract cost proposals. In this instance, the benefit of the T&M subcontract is that it allows the prime to quickly obtain participation from subcontractors, without obtaining a cost proposal for each task.

A second reason T&M subcontracts are preferred, are because

they simplify the invoice preparation, review, and payment approval processes. On a T&M subcontract, only the fully burdened contract rate is included on the invoice, and there is no need for additional rate data. This is especially beneficial when the contract includes the Supplemental Wide Area Workflow (WAWF) Payment Instructions⁹. These payment instructions require extensive rate detail for CPFF contracts and are a tremendous burden on both the prime and the subcontractor. These are just a few examples of why T&M contracts are preferable for subcontracting.

Problems with CPFF Subcontracts

Now, one reason the federal government prefers CPFF contracts is because they are entitled to audit rights. However, industry usually **does not** have the right to audit the books and records of the subcontractor. COs often do not understand the issues created by a prime contractor's lack of audit rights. A lack of audit rights can impact the contractor in the following ways:

1. Harder to negotiate and award CPFF subcontracts due to lack of visibility into the cost proposal rate detail.
2. Harder to review and approve invoices from the subcontractor due to lack of rate detail. Some prime contractors will require two invoices from the subcontractor, one for the CO with the rate detail, and one without the detail for the prime contractor.
3. Harder to negotiate changes to the subcontract for increases in rates or adding new labor categories.
4. Harder to close out the subcontract due to the inability to negotiate final indirect cost rates as required by the payment clause.¹⁰ This often takes the government 7 or 8 years to make this determination.

The Solution

The FAR states "A time-and-materials contract provides no positive profit incentive to the contractor for cost control or labor efficiency. Therefore, appropriate Government surveillance of contractor performance is required to give reasonable assurance that efficient methods and effective cost controls are being used"¹¹. To incorporate the concerns of FAR regarding T&M contracts, the prime contractor can apply the appropriate level of subcontractor surveillance by including the following responses to critics:

1. T&M contracts are not "cost plus percentage of cost" contracts. The profit or fee is included in the fixed hourly rates. The profit is a fixed amount for each labor category. In addition, the DoD makes extensive use of CPFF contracts where the Fee is a fixed rate per hour for any labor category. The Navy SeaPort-e¹² MAC contract includes this clause. Over 2,400 firms hold SeaPort-e contracts.
2. FAR requires all T&M contracts to include a "Not to

Exceed" (NTE) ceiling price. This price must be determined *fair and reasonable* based on Price or Cost Analysis. This reasonable NTE prevents the T&M subcontractor from charging unreasonable amounts.

3. The use of Uncompensated Overtime by exempt employees can be controlled by a subcontract clause. The subcontract clause can state either "no overtime is authorized on this contract" or "any overtime must be authorized in writing by the prime". The prime contractor should not approve overtime by exempt employees unless necessary.
4. Use of low wage employees in high rate labor categories can be mitigated by proper Price Analysis techniques and well established labor category qualifications. The T&M rate for each labor category must be reasonable for the pool of employees who meet the qualifications for that category. If a specific employee is highly compensated, a special labor category should be negotiated for that person.

Conclusion

In conclusion, the Time & Material contract type is indeed appropriate in certain subcontracting situations. Prime contractors should consider the advantages of T&M subcontracts over CPFF subcontracts and Contracting Officers should consider the increased burden of CPFF subcontracts on both the prime contractor and subcontractor. Finally, T&M subcontracts can be advantageous for both parties, but will also require additional oversight on the part of the prime contractor.

Notes and references

About the Author

Daniel A. Chalfant, CPCM is a Senior Cost/Price Analyst for General Atomics and teaches contract management at San Diego State University. For more information, please visit his website: www.alexanderassociatesllc.com or connect with him via email at: alexanderassociates@cox.net.

Footnotes:

- 1 DARS 2012-00016, dated Oct 11 2012
- 2 FAR 16.601(b)
- 3 FAR 16.601 (d)
- 4 GAO Report GAO-09-579 June 2009
- 5 DoD IG Report No. D-2010-081 August 27, 2010
- 6 Navy C4I SE N66001-12-D-0092
- 7 Navy C4I SR N66001-14-D-0141
- 8 FAR 52.244-2 Subcontracts
- 9 Supplemental to DFARS clause 252.232-7006
- 10 FAR 52.216-7 (d)
- 11 FAR 16.601 (c)
- 12 Navy SeaPort-e N00178-14-D-7587